PROJECT NO. 51871

REVIEW OF THE ERCOT SCARCITY PRICING MECHANISM	§ §	PUBLIC UTILITY COMMISSION OF TEXAS

SOUTH TEXAS ELECTRIC COOPERATIVE, INC.'S REPLY COMMENTS TO COMMISSION QUESTIONS ON THE LOW SYSTEM-WIDE OFFER CAP

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

COMES NOW, South Texas Electric Cooperative, Inc. ("STEC") and submits its Reply Comments in the above-styled proceeding. STEC's Reply Comments respond to the key concepts and proposals identified in the Initial Comments of multiple parties in this proceeding. The deadline for the filing of Reply Comments to be considered in the above-styled proceeding is March 26, 2021, therefore these comments are timely filed.

I. REPLY COMMENTS

1. Should the Commission amend its rules to adjust the LCAP?

Yes, see adjustments to same as set forth below.

2. If the Commission amends its rules to adjust the LCAP, what specific adjustments should it make?

A. STEC Supports Proposals to Cap LCAP at VOLL

STEC supports the recommendations of various commenters to limit the low system-wide offer cap ("LCAP") to the high system-wide offer cap ("HCAP"). There is broad consensus among the commenters that the LCAP was not intended to provide an offer cap greater than the value of lost load ("VOLL"). Limiting the LCAP to an amount not to exceed $9,000 will better align the function of the LCAP with its intended purpose.

B. STEC Opposes the Concept of "Operational" Scarcity Events

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STEC disagrees with the comments of Texas Industrial Energy Consumers ("TIEC") that the events of the winter storm reflect an "operational event" and do not signal a need for additional installed generation in ERCOT.[1] TIEC makes a sweeping claim that the longest period of rotating outages ever to occur in ERCOT is not an indication that some required level of reserves is needed. STEC disagrees. The Commission must address the fact that ERCOT needs reliability through existing resources (dispatchability during extreme weather conditions), mandatory reserve levels for both winter and summer events, and corresponding, increased reserve levels with more generation capacity available on the system. As articulated in the comments of Vistra Corp. ("Vistra"), scarcity events and forward pricing signals are the only methods to incentivize maintaining and increasing installed generation in the ERCOT energy-only market.[2] Arbitrarily removing scarcity pricing in scarcity events without a capacity backstop will undermine both short-term and long-term investment, will result in generation exiting the market and will make the energy-only market even less reliable in severe weather events.

C. STEC Supports an Event Based LCAP

STEC agrees in part with TIEC's comments regarding the use of an event-based LCAP.[3] STEC agrees that an event-based LCAP provides a more appropriate "circuit-breaker" than the current annual LCAP timeframe. However, STEC disagrees with TIEC's proposal to trigger the LCAP based on the number of hours at the HCAP and the designation of an "operational event." For the reasons stated above, designating a scarcity event as an operational event is ambiguous and impractical. STEC instead recommends an event-based trigger that is tied to the achievement of some multiple of the cost of new entry ("CONE") within a rolling period of time. It will be equally important to determine when to return to the HCAP from the LCAP. STEC

[1] TIEC's Initial Comments on the Low System-Wide Offer Cap at 2 (Mar. 19, 2021).
[2] Vistra's Comments In Response to March 8, 2021 Staff Request for Comments at 4 (Mar. 19, 2021).
[3] TIEC's Initial Comments on the Low System-Wide Offer Cap at 2 (Mar. 19, 2021).

offers that this could also be triggered by a time interval after the LCAP was triggered, or even by the achievement of a rolling calculation of Peaker Net Margin ("PNM") falling below a defined value (e.g. a percentage of CONE). This would balance the need to provide a long-term signal, while at the same time allowing for the protection of the market by continuing the effectiveness of the LCAP circuit breaker in scarcity events that provides market signals taking into account both the CONE and PNM.

D. STEC Opposes a Cost-Based Market Design

STEC opposes the LCAP changes proposed by NRG Energy, Inc. ("NRG") that rely heavily on cost-based recovery.[4] A cost-based recovery is appropriate for a fully regulated market, not an energy-only market that depends on price signals for generation investment. Regulating prices only in scarcity events while requiring generators to continue to provide power during low and negative pricing intervals will further push dispatchable generation out of the market and freeze investment. When generation is needed to support reliability, the generation should be priced at an amount that reflects the value of maintaining system reliability, unless generators are being compensated for capacity available at all times, and not just during scarcity pricing events. A make-whole payment in a scarcity event undermines the structure of the energy-only market and creates an increased likelihood of uplift to loads, including loads that appropriately hedged for the scarcity event. STEC cannot support the use of a static LCAP that removes scarcity pricing and provides little to no incentive for generation to be available during scarcity events.

E. STEC Opposes Proposals to Eliminate or Reduce the LCAP Fuel Index Price Multiplier

[4] NRG's Response to Request for Comments on the Low System-Wide Offer Cap at 3 (Mar. 19, 2021).

STEC strongly disagrees with NRG and the Office of Public Utility Counsel's ("OPUC") proposals to eliminate the 50 times fuel index price multiplier component from 16 TAC § 25.505(g)(6)(A)(ii).[5] It is important to maintain the natural gas component of the LCAP calculation because natural gas units are the marginal units, particularly in times of scarcity, that set the market clearing price of energy. Natural gas must be covered because "it accounts for changes in the cost of generation caused by fluctuations of the cost of fuel."[6]

STEC also disagrees with Potomac Economics' recommendation to lower the natural gas multiplier to 25X from 50X[7] and with the recommendation made by the Texas Coalition for Affordable Power ("TCAP") to lower the natural gas multiplier to 15X from 50X.[8] Neither Potomac Economics nor TCAP have provided justification for lowering the multiplier. The numbers put forward by these parties are arbitrary, and in the case where extreme price spreads occur across the State for natural gas as we had seen in February,[9] it could result in a generator being available, but not recovering its fuel costs.

The Commission previously concluded in Project No. 33490 that the multiplier of 50 times the Houston Ship Channel natural gas price index was appropriate because it "is high enough to cover total variable and operating costs of any existing generating unit in ERCOT, including inefficient peakers."[10] Arbitrarily reducing the natural gas multiplier would only serve

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[5] NRG's Response to Request for Comments on the Low System-Wide Offer Cap at 3 (Mar. 19, 2021); Office of Public Utility Counsel's Initial Comments at 2 (Mar. 19, 2021).
[6] *Rulemaking Proceeding to Address Pricing Safeguards in Markets Operated by the Electric Reliability Council of Texas*, Project No. 33490, Order Adopting Amendment to §25.505 as Approved at the August 16, 2007, Open Meeting at 29 (Aug. 16, 2007).
[7] Comments of Potomac Economics at 2 (Mar. 19, 2021).
[8] Comments of Texas Coalition for Affordable Power at 2 (Mar. 19, 2021).
[9] *See* Vistra's Comments In Response to March 8, 2021 Staff Request for Comments at 4 (Mar. 19, 2021).
[10] *Rulemaking Proceeding to Address Pricing Safeguards in Markets Operated by the Electric Reliability Council of Texas*, Project No. 33490, Order Adopting Amendment to §25.505 as Approved at the August 16, 2007, Open Meeting at 29 (Aug. 16, 2007).

to artificially reduce the price ceiling to the detriment of generators, which would further undermine resource adequacy.

F. STEC Opposes Elimination of the PNM

STEC is not persuaded by TIEC's recommendation to replace "the current PNM-based LCAP entirely."[11] STEC disagrees with TIEC's assertion that the PNM is not a meaningful metric because it measures revenues based solely on real-time prices and does not include revenues from the day-ahead market, or other revenues from bilateral or forward transactions. Including day-ahead market prices and other revenues would make the PNM threshold more likely to be reached in times of high prices that would signal a functioning market in a market with little to no reserves. The PNM and LCAP are designed to be stop-gap mechanisms in extreme circumstances; they are not designed to operate as a ceiling on prices.

STEC recommends that the Commission maintain the PNM. Maintaining the PNM threshold ensures that generators are incentivized to continue to provide generation in the market, ensuring a continued availability of generation that is low-cost in the many intervals of the year in which resources are not scarce. Reserves have steadily and rapidly declined, particularly reserves sourced from dispatchable generation—a sign of a market that ascribes no value to capacity and does not send adequate pricing signals to sustain, or encourage the siting of, generation.

3. If the Commission amends its rules to adjust the LCAP, when should these adjustments take effect?

As agreed by most parties, these changes should be effective prior to entering the summer months with a reserve margin that is less than the 1-in-10 year Loss of Load Event.[12]

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[11] Texas Industrial Energy Consumers' Initial Comments on the Low System-Wide Offer Cap at 7 (Mar. 19, 2021).
[12] "Estimation of the Market Equilibrium and Economically Optimal Reserve Margins for the ERCOT Region for 2024", Astrape Consulting, January 15, 2021.

II. CONCLUSION

In the absence of a capacity backstop, the energy only market and its associated volatility must at least result in scarcity pricing to retain existing generation. STEC appreciates the Commission's review of these important issues.

Respectfully submitted,

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